REPORT OF
FINANCIAL EXAMINATION

CAPE MUTUAL INSURANCE COMPANY

AS OF
DECEMBER 31, 2003

STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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September 21, 2004
Liberal, Missouri

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Sir:

In accordance with your examination warrant, a full-scope examination has been made of the records, affairs and financial condition of

CAPE MUTUAL INSURANCE COMPANY

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 120 South Main (P.O. Box 40), Liberal, Missouri, telephone number (417) 843-6265. This examination began on September 20, 2004, and was concluded on September 21, 2004, and is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered

The prior full-scope examination of the Company was made as of December 31, 1998, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 1999, through December 31, 2003, and was conducted by examiners from the Missouri Department of Insurance.

This examination also included material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri

prevailed.

Comments-Previous Examination Report

The comments, recommendations, and notes of the previous examination report dated December 31, 1998, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

Fidelity Bond and Other Insurance

Comment: It was recommended the Company obtain a minimum of $75,000 in fidelity bond coverage for its officers.

Company Response: Effective May 19, 1999, the Company secured additional fidelity bond coverage for its officers exceeding the recommended minimum level.

Current Findings: The Company's current fidelity bond coverage level appears to comply with the minimum amount suggested by the NAIC.

Accounts and Records

Comment: It was recommended the Company comply with Section 380.471 RSMo. (Investments), which requires the value of real estate under mortgage loans be at least twice the amount loaned thereon.

Company Response: The mortgage loan referenced is on the former home office of the Company, located in Cape Girardeau, Missouri. Due to the Company's relocation to Liberal, Missouri, the Company sold the building for $68,500, with ten percent down, financing the balance over a ten-year period at 8.50% compounded monthly. The current replacement cost of the building is in excess of $150,000, which is more than twice the original loan value and nearly three times the current balance of the loan.

Current Findings: The current mortgage loan balance reported by the Company meets the provisions of Section 380.471 (Investments).

HISTORY

General

The Company was organized on April 21, 1903, and operated under the name of Merchants' and Mechanics' Mutual Aid Society as an unincorporated company. In 1935, the Company was incorporated and changed its name to Merchants' and Mechanics' Mutual Fire Insurance Company. On April 24, 1969, the Company amended its Articles of Incorporation, changing its name to Cape Mutual Insurance Company. In 1997, the Company moved its home office from Cape Girardeau, Missouri to Liberal, Missouri.

The Company has a Certificate of Authority dated July 1, 1991, and is covered by Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company's Certificate of Authority is renewed annually.

Management

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is held on the fourth Thursday in March, at the home office of the Company or at such other place as may be designated by the Board of Directors. Special meetings of the members may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the Members. Eight members shall constitute a quorum at any membership meeting. Proxy voting is permitted.

The management of the Company is vested in the Board of Directors, who are elected from the general membership. The Board of Directors consists of five members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every quarter, and each member receives compensation of $200 per each meeting attended.

Members serving on the Board of Directors as of December 31, 2003, were as follows:

Name and Address	Occupation	Term
Fred H. Shaw 210 West Maple Liberal, Missouri	Retired Insurance Executive	2002-2007

Sally S. Fast 210 North Denton Liberal, Missouri	Insurance Executive	2003-2008
James L. Thurman Route 2 Box 94 Ava, Missouri	Retired Insurance Agent	2000-2005
Keith Keltner 1185 NW 20th Road Liberal, Missouri	Retired Insurance Agent	2001-2006
Thomas J. Shaw 302 Walser Liberal, Missouri	Insurance Executive	1999-2004

The Board of Directors appoints for a term of one year, a Chairman, a President/Secretary/Treasurer, and a Vice President.

The officers of the Company serving at December 31, 2003, were as follows:

James L. Thurman	Chairman
Joel E. Dermott	President/Secretary/Treasurer
Thomas J. Shaw	Vice-President

Conflict of Interest

The Company has written conflict of interest procedures for the disclosure of material conflicts of interest or affiliations by its directors and officers. The Company has its directors and officers sign conflict of interest statements on an annual basis, and no material potential conflicts were disclosed.

Corporate Records

A review was made of the Articles of Incorporation and the Bylaws of the Company. The Articles of Incorporation were amended on March 21, 2001, to change the annual membership meeting date to the fourth Thursday in March and to set the quorum requirement at such meetings at eight members.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. In addition, the Company's policies for investments and underwriting were reviewed.

The minutes and records of the Company appear to properly reflect corporate transactions and events.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond along with related companies Barton Mutual Insurance Company (Barton Mutual) and Gateway Mutual Insurance Company (Gateway Mutual). The bond provides a limit of liability of $250,000 per loss and unlimited in the aggregate. The fidelity bond coverage of the Company meets the minimum amount suggested in the guidelines promulgated by the NAIC, which is between $250,000 and $300,000 in coverage.

The Company is a named insured, along with Barton Mutual and Gateway Mutual, on a directors' and officers' liability policy. The coverage provides an annual aggregate limit of $2,000,000 and a $25,000 per loss deductible.

The Company utilizes only independent agents and requires the agents to purchase errors and omissions insurance at their own expense.

The Company does not own its home office or equipment and thus does not carry property insurance. The Company is a named insured, along with Barton Mutual and Gateway Mutual, on a business liability policy, which provides an annual aggregate limit of $2,000,000.

The insurance coverage appears adequate.

EMPLOYEE BENEFITS

The Company has no employees. Human resource services are provided by Barton Mutual under a cost sharing agreement. The Company pays Barton Mutual a monthly fee for the services, equal to 16.21% of direct premium written by the Company. The agreement also requires monthly payments of $375 for home office space and $175 for utilities.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company is licensed by the Missouri Department of Insurance as an Extended Missouri Mutual Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company is authorized to write fire, wind and liability insurance in all counties in the State of Missouri. The Company writes fire, wind and liability coverages. The Company's policies are sold by over 700 licensed producers, who receive a 23% commission on new business and a 15% commission on renewal business.

Policy Forms and Underwriting Practices

The Company uses AAIS policy forms. The policies are written on a continuous period. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured. Field representatives employed by Barton Mutual perform inspections and adjusting services.

GROWTH AND LOSS EXPERIENCE OF THE COMPANY

	Admitted Assets	Liabilities	Gross Assessment	Gross Losses	Investment Income	Underwriting Income	Net Income
2003	$3,039,265	$2,727,715	$5,903,653	$5,865,136	$67,947	$(564,367)	$(470,016)
2002	2,781,081	2,199,515	4,906,312	2,595,010	86,199	(210,777)	(100,281)
2001	2,408,617	1,726,770	3,901,485	2,910,623	105,701	(352,783)	(223,462)
2000	2,783,362	1,878,053	3,652,606	1,580,196	136,680	(133,816)	22,479
1999	2,530,028	1,706,542	3,568,561	1,495,068	88,409	109,748	209,669

At year-end 2003, 11,303 policies were in force.

The Company has experienced significant underwriting losses in each of the last four years and

significant net losses in each of the last three years. The negative experience resulted in the Company's failure to meet the minimum policyholder surplus requirements of Section 380.271 RSMo. (Guaranty fund required) at December 31, 2003 (See the "Notes to the Financial Statements" section of this report). It is recommended the Company review its underwriting procedures and expense structure, and implement necessary changes in an attempt to return the Company to profitability.

REINSURANCE

General

The Company's reinsurance premium activity on a direct-written, assumed and ceded basis for the period under examination is shown below:

	1999	2000	2001	2002	2003
Direct	$2,440,218	$2,592,819	$2,686,097	$3,394,119	$4,105,543
Assumed	1,128,343	1,059,787	1,215,388	1,512,193	1,798,110
Ceded	(1,647,083)	(1,700,283)	(1,870,007)	(2,249,022)	(2,730,151)
Net	$1,921,478	$1,952,323	$2,031,478	$2,657,290	$3,173,502

Assumed

The Company participates in a reinsurance pool with MAMIC Mutual Insurance Company (MMIC). The agreement pertains to errors and omissions policies and director and officer liability policies written by MMIC. MMIC cedes 100% of the first $1,000,000 each claim and in aggregate on all insurance agent and broker errors and omissions policies and 100% of the first $2,000,000 each claim and in aggregate on all officer and director liability policies to the pool. MMIC receives a 35% ceding commission of net written premium ceded to the pool. The Company has a 3% share in the interests and liabilities of the pool.

The Company has a pro-rata reinsurance treaty with Barton Mutual under which the Company assumes a limit of $30,000 per risk after Barton Mutual's retention and underlying reinsurance limits of $90,000 per risk. Barton Mutual receives a ceding commission of 35% of premiums ceded under the

agreement.

The Company is a member of the Missouri Mutual Reinsurance Exchange, a group reinsurance pool consisting of five Missouri Mutual companies. The exchange is managed by Guy Carpenter & Company, Inc. of Pennsylvania (Guy Carpenter). Risk and premium assumptions are based proportionately on the risks ceded by each participant to the pool in the prior year.

Ceded

The Company cedes 100% of liability risks insured under a casualty reinsurance agreement, with Barton Mutual. Cessions under the agreement are limited to $1,000,000. Although the agreement states a ceding commission of 20%, Barton Mutual currently receives 30% ceding commission. It is recommended the Company amend the casualty reinsurance agreement with Barton Mutual to reflect the current ceding commission rate.

The Company has pro-rata reinsurance agreements under which the Company retains $30,000 per risk. The next $30,000 is ceded to the Missouri Mutual Reinsurance Exchange under a first surplus reinsurance treaty. The Company receives a 35% ceding commission on premiums ceded under the agreement. Losses in excess of $60,000 are ceded to Barton Mutual under a pro-rata reinsurance treaty. The agreement limits each policy to $920,000 and provides for a 35% ceding commission.

The Company has an aggregate excess of loss reinsurance agreement through broker Guy Carpenter. Under the agreement, the participating reinsurers are liable for 95% of losses in excess of an attachment point. The attachment point is equal to the greater of 65% of the Company's net earned premium for the calendar year, or $1,105,000. The liability of the reinsurers is limited to the lesser of 95% of 237% of the Company's net earned premium or 95% of $6,056,300. Reinsurance premium is equal to 6.15% of subject net premium. Participating reinsurers in 2003 included Arch Reinsurance Company at 55%, Excess Reinsurance Company at 20%, Farm Mutual Reinsurance Plan, Inc. at 20% and Employers Mutual Casualty Company at 5%.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that any assuming reinsurer should fail to perform its obligations under its reinsurance agreement with the Company.

ACCOUNTS AND RECORDS

The accounting records are maintained by the Company on an accrual basis. The compilation of the Company's Annual Statement is performed by Schott & Van de Ven, CPAs.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2003, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for each individual annual statement item.

ANALYSIS OF ASSETS
December 31, 2003

Bonds	$ 562,081
Mortgage Loans on Real Estate	30,788
Cash on Deposit	542,577
Other Investments	56,834
Premium Receivable	77,732
Reinsurance Recoverable	1,040,710
Interest Due and Accrued	3,894
Asset Write-Ins	724,649
Total Assets	$ 3,039,265

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2003

Losses Unpaid	$ 380,563
Ceded Reinsurance Payable	135,170
Unearned Premium	1,995,319
Liability Write-Ins	216,663
Total Liabilities	$ 2,727,715
Guaranty Fund (Note 1)	$ 700,000
Surplus Notes	200,000
Other Surplus (Note 2)	(588,450)
Total Surplus	$ 311,550
Total Liabilities and Surplus	$ 3,039,265

STATEMENT OF INCOME
December 31, 2003

Net Premium	$ 2,748,563
Reinsurance Commission	857,260
Net Losses Incurred	(2,061,688)
Other Underwriting Expenses	(2,108,502)
Net Underwriting Income (Loss)	$ (564,367)
Investment Income	$ 67,947
Other Income	26,404
Gross Income (Loss)	$ (470,016)
Federal Income Tax	0
Net Income (Loss)	$ (470,016)

CAPITAL AND SURPLUS ACCOUNT
December 31, 2003

Policyholders' Surplus, December 31, 2002	$ 581,566
Net Income (Loss)	(470,016)
Surplus Note	200,000
Policyholders' Surplus, December 31, 2003	$ 311,550

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Guaranty Fund

The guaranty fund amount of $111,550 reported by the Company was understated by $588,450. The guaranty fund per the examination equaled $700,000.

Note 2 – Other Surplus

The surplus level of the Company at December 31, 2003 did not meet the minimum guaranty fund requirements of Section 380.271 RSMo. (Guaranty fund required). The Company's surplus of $311,550, which included a surplus note of $200,000 issued to Gateway Mutual Insurance Company (Gateway Mutual), was less than the required guaranty fund of $700,000, by $388,450. In 2004, the Company issued additional surplus notes totaling $541,956. This total consisted of an additional $150,000 under a surplus note with Gateway Mutual, for a total of $350,000 to Gateway Mutual. A total surplus note issuance of $400,000 to Gateway Mutual was approved by the Missouri Department of Insurance. The remaining proceeds consisted of $391,956 received under a surplus note issued to Barton Mutual, which was also approved by the Missouri Department of Insurance. The capital received as a result of the issuance of the surplus notes appears to have subsequently brought the Company into compliance with Section 380.271 RSMo. (Guaranty fund required).

EXAMINATION CHANGES

	Increase in Surplus	Decrease in Surplus	
Total Policyholder's Surplus Per Company, December 31, 2003			$ 311,550
Guaranty Fund	$ 588,450	$ 0	
Other Surplus	0	(588,450)	
	-----------	-----------	
Total Change	$ 588,450	$ (588,450)	(0)
Total Policyholder's Surplus Per Examination, December 31, 2003			$ 311,550

GENERAL COMMENTS AND RECOMMENDATIONS

Growth and Loss Experience of the Company (Page 6)

It is recommended the Company review its underwriting procedures and expense structure, and implement necessary changes in an attempt to return the Company to profitability.

Reinsurance Ceded (Page 8)

It is recommended the Company amend the casualty reinsurance agreement with Barton Mutual to reflect the current ceding commission rate.

SUBSEQUENT EVENTS

As referenced in the 'Note 2 – Surplus Notes' in the "Notes to the Financial Statements" section of this report, the Company received capital of $150,000 and $391,956 from Gateway Mutual and Barton Mutual, respectively, as a result of surplus notes issued by the Company in 2004.

ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Cape Mutual Insurance Company during the course of this examination is hereby acknowledged and appreciated.

VERIFICATION

State of Missouri)
) ss
County of Cole)

I, Shannon W. Schmoeger on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only the facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Shannon Schmoeger

Shannon W. Schmoeger, CFE
Financial Examiner
Missouri Department of Insurance

Sworn to and subscribed before me this 4th day of January, 2005

My commission expires:

Oct. 7, 2005

Rayna S. Rice
Notary Public

RAYNA S. RICE
Notary Public - State of Missouri
County of Cole
My Commission Expires Oct. 7, 2005

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Frederick G. Heese

Frederick G. Heese, CFE, CPA
Audit Manager – Kansas City
Missouri Department of Insurance

BARTON
MUTUAL GROUP
Barton • Cape • Gateway
P O Box 99 Liberal, MO 64762
Phone 417-843-6265 Fax 417-843-2245

February 14, 2005

Kirk Schmidt, Chief Financial Examiner
Missouri Department of Insurance
P. O. Box 690
Jefferson City, MO 65102-0690

RECEIVED
FEB 18 2005
MO INS DEPT

Re: Examination Report

Dear Mr. Schmidt,

I am in receipt of the Examination Report for Cape Mutual Insurance Company for the period ending December 31, 2003. Concerning the General Comments and/or Recommendations contained on page 13 of the report, we wish for the following responses to be included in the final report.

Growth and Loss Experience of the Company (Page 6)

The Company annually reviews and evaluates its underwriting guidelines and rate structures for each line of business. A five-year comprehensive review of income and loss history for each program is presented to the Board of Directors annually along with management's recommendations for rate adjustments and changes in underwriting guidelines. The Board in turn has acted upon those recommendations by approving rate adjustments and revising underwriting guidelines in each of the past five years. In addition after 2003's two hundred fifty year storm event produced catastrophic losses, the Board not only revised rates but also implemented a $20.00 policy fee earmarked for surplus rebuilding. Other actions the Board has implemented include the reduction of agent commission rates, revamping of the Company's overhead expense sharing agreement with Barton Mutual Insurance and restricting growth of new business writings.

An extended hard market, which has produced unprecedented company wide growth coupled with increasing storm related losses have been the basis for the Company's poor results in recent years. We remain confident in the direction our basic underwriting principals are taking us. A strong agency force backed by an intensive inspection program remains the only viable means by which we can continue to operate as an insurance company. Since 1994, wind/storm related losses have outpaced fire losses nearly 2:1 in claim dollars spent. Arson, fraud and shoddy underwriting practices have not been the culprit. Rather, we can look at a competitive market place where rates have been held artificially low in order to maintain market share as the genesis. Our problems reside on the pricing side where, in truth, we have charged the consumer too little to adequately cover the exposures created by ever inflating building costs and housing values. We have made great strides in the past two years in correcting our pricing deficiencies without overburdening the consumer with unrealistic rate increases.

BARTON
MUTUAL GROUP
Barton • Cape • Gateway
P O Box 99 Liberal, MO 64762
Phone 417-843-6265 Fax 417-843-2245

We remain focused on refining our operations and investing in technology to gain further efficiency all the while keeping one eye firmly planted on maintaining overhead costs in order to deliver to our insureds the most value for their insurance dollar. Furthermore, the Board of Directors and Management are committed to bringing this Company back to a level of profitability and strength that has been our standard for year's past.

Reinsurance Ceded (Page 8)

Attached please find an amended copy of the Casualty Reinsurance Agreement with Barton Mutual Insurance Company whereas the reinsurance ceding commission rate was revised from 20% to 30%.

In closing, we would like to thank Shannon Schmoeger for his professionalism in conducting the financial exam of our company.

Sincerely,

Joel E Dermott

Joel E. Dermott, President
CAPE MUTUAL INSURANCE COMPANY

JED/me
Attachment

RECEIVED
JAN 27 1992

BARTON COUNTY MUTUAL INSURANCE COMPANY

Casualty Reinsurance Agreement

Amendment 01

Effective 1-1-92

I. Article X - SERVICE CHARGE is deleted and the following replaces:

The reinsurer shall allow the Company to retain 30 per cent of the premiums collected under this Agreement for their services in issuing and servicing policies issued to provide said coverage.

IN WITNESS WHEREOF the parties hereto by their respective duly authorized officers have executed this Amendment as of the date signed, effective when stated above.

Leon Whitler	1-21-92	Thomas J. Shaw	1/23/92
Leon Whitler, Secretary	Date	Thomas J. Shaw, Pres.	Date
Cape Mutual Ins. Co.		Barton County Mutual Ins.	